

Amend Section 2840 to read:

2840. Approved Borrower Disclosure Statements

(a) The Commissioner shall publish and make available to interested persons as official forms of the Department of Real Estate Forms RE 882 (Rev. 8/08) and RE 883 (Rev. 8/08) which are incorporated by reference. Forms RE 882 and RE 883 contain approved format and content for the disclosure statement required by subdivision (a) of Section 10240 of the Code and Section 10241 of the Code.

(b) The publication of the forms pursuant to subdivision (a) hereof is for the purpose of aiding real estate licensees in providing the disclosure of material information to prospective borrowers in a uniform and effective manner.

(c) A real estate broker must obtain the prior written approval of the Commissioner if he/she wishes to use forms different than those referred to in (a). Forms that do not adequately provide the information required by the forms in subsection (a) above, as appropriate, and in a format that is easily used by the Department will not be approved.

NOTE: Authority cited: Sections 10080 and 10240.3, Business and Professions Code.
Reference: Sections 10240, 10240.3 and 10241, Business and Professions Code.

Amend Section 2842 to read:

2842. Approved Borrower Disclosure Statement For Nontraditional and Subprime Mortgage Products

(a) Notwithstanding Section 2840 of these regulations, the Commissioner shall publish and make available to interested persons as an official form of the Department of Real Estate Form RE 885 (Rev. 8/08) which is incorporated by reference, with approved format and content for the disclosure statement referred to in subdivision (a) of Section 10240 of the Code and Section 10241 of the Code.

(b) The publication of the form pursuant to subdivision (a) hereof is for the purpose of aiding real estate licensees in providing the disclosure of material information in a uniform and effective manner to prospective borrowers relating to home loans on one-to-four unit single-family residences whose loans involve a "nontraditional mortgage product" as that term is defined in subsection (c) below.

(c) For the purpose of this regulation, a "nontraditional mortgage product" is a loan that allows borrowers to defer repayment of principal or interest. Such products include, but are not limited to, interest only loans where a borrower pays no loan principal for a period of time and payment option loans where one or more of the payment options may result in negative amortization.

A "nontraditional mortgage product" does not include reverse mortgages or home equity lines of credit (other than simultaneous second lien loans).

(d) A real estate broker must obtain the prior written approval of the Commissioner if he/she wishes to use a form different than that referred to in subsection (a) above with a nontraditional mortgage product. Forms that do not adequately provide the information required by Sections 10240 and/or 10241 of the Code, as appropriate, and in a format that is easily used by the Department, will not be approved.

NOTE: Authority cited: Sections 10080 and 10240.3, Business and Professions Code.
Reference: Sections 10236.4, 10240, 10240.2, 10240.3 and 10241, Business and Professions Code.

Adopt Section 2844 to read:

2844. Lending Practices for Nontraditional and Subprime Mortgage Products

- (a) A real estate broker acting within the meaning of Section 10131.1 of the Code shall adopt and adhere to the policies and procedures set forth in the guidance on nontraditional mortgage product risks published on November 14, 2006, by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, and the Statement on Subprime Mortgage Lending published on July 17, 2007, by the aforementioned entities and the National Association of Consumer Credit Administrators, and which are incorporated by reference.
- (b) Pursuant to subdivision (a), a real estate broker shall, at a minimum, adopt and adhere to the following:

- (1) Risk Management Practices

- (A) Consider a borrower's ability to repay the mortgage loan according to its terms as the primary basis for making the loan rather than the foreclosure or liquidation value of the collateral.
 - (B) Ensure that a loan results in an identifiable benefit to the borrower and refrain from inducing a borrower to repeatedly refinance a loan in order to charge high points and fees each time the loan is refinanced.
 - (C) Fully disclose the true nature of the mortgage loan obligation, or ancillary products to the borrower.

- (2) Underwriting Standards

- (A) Analyze a borrower's repayment capacity to include an evaluation of his/her ability to repay the loan by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule. For products that permit negative amortization, a repayment analysis should be based on the initial loan amount plus any balance increase that may accrue from the negative amortization.
 - (B) Avoid combining nontraditional loan features such as interest-only or negative amortization loans with reduced documentation or simultaneous second-lien loans (piggyback) unless there are mitigating factors such as high credit scores, low loan to value ratios (LTVs) and debt to income ratios (DTI), significant liquid assets, mortgage insurance or other credit enhancements.

- (C) Accept stated income or reduced documentation only if there are mitigating factors that clearly minimize the need for direct verification of the borrower's repayment. The mitigating factors shall be documented.
- (D) When setting introductory rates on adjustable rate mortgages, consider the spread between the introductory rate and the fully indexed rate to minimize negative amortization, "payment shock" and earlier-than-scheduled recasting of monthly payments. Pursuant to the Statement on Subprime Mortgage Lending "... [p]ayment shock refers to a significant increase in the amount of the monthly payment that generally occurs as the interest rate adjusts to a fully indexed basis. Products with a wide spread between the initial interest rate and the fully indexed rate that do not have payment caps or periodic interest rate caps, or that contain very high caps, can produce significant payment shock".
- (E) When making loans to borrowers ensure that such programs do not feature terms that could become predatory or abusive as described in the "Statement on Subprime Mortgage Lending" under "Predatory Lending Considerations" and the "Guidance on Nontraditional Mortgage Product Risks" under "Lending to Subprime Borrowers".
- (F) Qualify borrowers financing non-owner occupied investment properties on their ability to service the debt over the life of the loan and require evidence that the borrower has sufficient cash reserves to service the loan considering the possibility of extended periods of property vacancy and the variability of debt service requirements associated with nontraditional mortgage loan products.
- (G) Qualify a borrower's repayment capacity by a debt-to-income (DTI) ratio that includes an assessment of the borrower's total monthly housing-related payments (e.g. principal, interest, taxes and insurance) and total monthly obligations as a percentage of gross income.

(3) Control Systems

- (A) Design compensation programs that avoid providing incentives for originations inconsistent with sound underwriting and consumer protection principles. Such programs should not result in the steering of consumers to products resulting in payment shock or containing prepayment penalties, balloon payments or a higher cost due to reduced documentation or stated income, to the exclusion of other products for which the consumer may qualify.
- (B) Monitor the quality of third-party originations so that they reflect the broker's lending standards and compliance with the Real Estate Law, Regulations of the Real Estate Commissioner and other applicable state and federal laws and regulations.

(4) Consumer Protection

- (A) In approving loans, primarily consider the borrower's ability to repay the mortgage loan according to its terms.
- (B) Assist the consumer in selecting a product by providing information that enables the consumer to understand material terms, costs, and risks of loan products.

- (C) When offering mortgage product descriptions and advertisements, provide clear, detailed information about the costs, terms, features, and risks of the loan to the borrower including:
- Potential payment shock
 - Negative amortization
 - Prepayment penalties
 - Balloon payments
 - Cost of reduced documentation loans
 - Responsibility for taxes and insurance
- (D) Provide monthly statements to consumers who have Payment Option adjustable rate mortgages (ARMs) which include information that enables consumers to make informed payment choices, and which include an explanation of each payment option available and the impact of that choice on loan balances.
- (E) Avoid leading borrowers who have Payment Option ARMs to select a non-amortizing or negatively amortizing payment.

NOTE: Authority cited: Sections 10080 and 10240.3, Business and Professions Code.
Reference: Sections 10131.1, 10240.3 and 10245, Business and Professions Code.